NO. 2697

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

IN THE MATTER OF SOUTHERN ARIZONA SMELTING COMPANY, a corporation, *Bankrupt,*

JOHN H. MARTIN, as Trustee of the estate of IMPERIAL COPPER COMPANY, a corporation, Bankhupt, *Petitioner,*

vs.

M. P. FREEMAN, as Trustee of the Estate of SOUTHERN ARIZONA SMELTING COMPANY, a corporation, Bankrupt, *Respondent.*

APPLICATION FOR REHEARING

FRANCIS M. HARTMAN,
EDWIN F. JONES,
Attorneys for Petitioner.

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Having carefully examined the opinion of the Honorable Court, we think that, with propriety, we may ask the Court to consider whether this case be not one in which it will be proper to grant a rehearing to petitioner on the grounds that:

The opinion of the Court is bottomed on the idea that by bankruptcy, either voluntary or involuntary, the entire estate of the bankrupt is devoted to the payment of his debts, and that all liens which exist against the property of the bankrupt, acquired within four months of the adjudication are *ex vi termini* denounced and destroyed by the Bankrupt Act.

Let it be admitted that "a person against whom a peti-

tion has been filed shall include a person who has filed a voluntary petition" and that therefore the petitioner would not be entitled to any greater consideration than would be awarded him against an involuntary bankrupt, and that a creditor of the Smelting Company would have no rights which a creditor would not have if that company had been forced into bankruptcy by its creditors.

The fundamental contention of petitioner is that it is necessary for the person (whether a voluntary or involuntary bankrupt) to be *insolvent* at the time the lien attaches before the bankrupt act denounces and destroys such lien.

Sec. 67c would seem to lean to this view for it declares that a lien created by or obtained in a suit, etc., shall be dissolved by the adjudication of (1) "it appears that the lien was obtained and permitted while the defendant *was insolvent* and that its existence and enforcement will work a preference."

Sec. 67f is as follows: That all levies, judgments, attachments, or other liens obtained through legal proceedings against a person who is insolvent at any time within four months prior to the filing of a petition in bankruptcy against him shall be deemed null and void in case he is adjudged a bankrupt.

The case of Stone Ordean Wells Co. vs. Mark, 227 Fed. 975, and which was cited in our brief, is a clear cut decision that the insolvency must be both alleged and proved by the person who claims the lien is void. This Court does not in terms dissent from its reasoning. It applies the rule in *Cook v. Robinson* as showing why a different conclusion is reached. Let us then consider the reasoning on which that case is founded, and the reasons given for the conclusions reached.

This Court in that case used this language, in stating the issues:

> "So the petitioner presents two *cardinal issues* * * * *Robertson's insolvency* and the *commission of an act of bankruptcy.* Upon consideration of these he was adjudged a bankrupt. (Italics ours.)

It does not require argument to show that both of these issues may be litigated and have evidence pro and con produced to sustain or controvert them. It is provided by the Bankrupt Act that *any creditor may appear and plead* to the petition within five days after the return day.

It is clearly shown that the Act with care gives to the holder of a lien the right to appear and litigate the question whether or not the facts which Congress had declared shall destroy his lien, exist in any case of an involuntary petition, and it is on this ground that the Court proceeds to hold them bound by the adjudication, for it proceeds:

Creditors of a bankrupt *are parties* to the proceedings to have him so adjudged, and are precluded by the adjudication in so far at least *as it determines the debtor's insolvency* and that he has committed an act of bankruptcy within four months prior to the filing of the petition and Judge Wolverton in his opinion, after stating the position thus taken, says:

> "Being parties to the bankruptcy proceedings it must follow that the creditors are precluded by the adjudication *upon such issues as must necessarily* be determined in order to pass Judgment."

In that case it is not decided that persons not parties are bound, but it is based on the idea that the attaching credior, by showing that the person against whom the petition was filed was solvent, could have defeated the adjudication and preserved his lien. The creditor did not resist adjudication in that case. If the law thus preserves to the attaching creditor in an involuntary proceeding the tribunal and the right to invoke that tribunal and litigate to protect his rights, why should the creditor of a voluntary bankrupt not have opportunity and standing in the

bankrupt court to litigae the facs on the existence of which Congress has declared his lien to be destroyed?

There can be no doubt that a creditor is not and cannot be a party to a voluntary proceeding until after adjudication and that he can not resist the adjudication by plea and proof that the debtor was really able to pay his debts. This proposition is fully decided in the case In re Fowler, 1 Lowell, 161, cited by the Court. An examination of that case shows that the ground ruled on there was that the debtor had concealed assets, and this was met by the decision that the assignor could recover them. No lien of any kind was claimed or asserted.

The case of Hanover Natl. Bank v. Moyses, 186 U. S. 181, decides but a single question and that is that a voluntary bankruptcy under the Act of 1898 is constitutional. It admitted that "the extent to which liens obtained by prior judicial proceedings should be recognized was a matter wholly within the discretion of Congress," but it is insisted that Congress has only avoided liens against persons who *were insolvent* at the time the lien was acquired and that there must be a tribunal and a proceeding in which the person claiming the lien can litigate the existence or non existence of the facts on which Congress has declared his lien annulled.

The Court here uses this language:

> "We think there should be none (distinction between voluntary and involuntary proceedings) when it is kept in mind that it was the intention of Congress to prevent creditors of a bankrupt from obtaining preferences over other creditors through legal proceedings had within four months prior to the filing of the petition."

The Court states that the intention of Congress was to "prevent creditors of a bankrupt from gaining preferences over other creditors through legal proceedings had within four months prior to the filing of the petition" and

cites the language used in In re Kenney, 105 Fed. 897, holding "that the property of the bankrupt is safeguarded against all such proceedings."

The evil then against which Congress was legislating was the creation of preferences through legal proceeding and there must be some place and time when the party claiming a lien may have the opportunity to show that the enforcement of his lien will not have such effect, even if it be held that the burden is not on the party assailing the lien, as decided in Stone Ordean Wells Co. vs. Mark, 227 Fed. 975.

If no injury can come to any creditor by the enforcement of the lien, and sufficient property remains in the hands of the voluntary bankrupt or his trustee, on what principle of law or logic, and by what rule of equity or fairness should the lien holder be deprived of his legal remedies for the enforcement of his debt and compelled to await the complete distribution of the bankrupt's estate, simply because the debtor is willing to have his property distributed by the bankrupt court, and have the surplus returned to him after his debts are paid?

It is earnestly insisted that the Bankrupt Act denounces and destroys only liens which inevitably and clearly under the facts of each case work a preference in favor of the lien holder to the damage of another creditor and that no debtor may halt his creditor in the use of lawful means to collect his debt because he is willing that a trustee in bankruptcy should administer his property till his debts are paid, and that no step taken by the debtor to which the lien holder may not be made a party and litigate his rights can conclude the lien holder or stamp his lien as void and of no effect.

It would be difficult to see how a preference could be obtained against a person who is solvent and who can be forced by appropriate legal process outside of bankruptcy

to pay all of his debts including the debt on which the attachment is founded, by the enforcement of the attachment, and appropriate legal remedies as to other debts, and unless such results will follow from the attachment it cannot injure the other creditors. In each of the cases cited by the Court it is clear that such results would follow.

In re Kenney shows a levy and sale of the entire estate, and an application of the proceeds to the claim of the attaching creditor, leaving nothing for the others. The case of Metcalf vs. Barker, 187 U. S. 165, clearly shows that the bankrupt was insolvent at the time and for eighteen months before the petition in bankruptcy was filed.

The case of In re Vaughan, 97 Fed. 560, uses this language: "The preference acquired by the creditor if the levy is not set aside, and its consequent injury to other creditors and its subversion *pro tanto* of the manifest intent and policy of the Bankruptcy Act, are in both cases precisely the same." The inevitable inference is that in that case the facts showed a resulting preference. The logic in that case could have no application to the estate of a *"solvent bankrupt"* filing a voluntary petition.

The case of In re Ricards, 96 Fed. 935, also clearly shows that in that case the insolvency of the bankrupt existed at the time the lien was acquired.

Every case, therefore, cited in the opinion is founded on facts showing insolvency at the time the lien was acquired, or that the question of insolvency could have been litigated by the attaching creditor and had not been challenged.

It is earnestly insisted that the attaching creditor cannot be deprived of his lien unless the bankrupt was insolvent at the time it was acquired, and that, having the privilege to litigate that fact in involuntary proceedings and being denied it in voluntary proceedings, a broad line of distinction is furnished for the difference in the effect of an adjudication in the two classes of case.

If proof of solvency would have defeated an involuntary adjudication and preserved the lien, why should not that right be saved to the attaching creditor in a voluntary case.

Counsel request that the Court re-examine the authorities cited in our brief on file, especially the reasning in Jackson vs. Valley Tie & Lumber Co., 108 Va. 714, where the exact question here presented is fully discussed and passed on.

Wherefore, upon the foregoing grounds, this petitioner respectfully prays this Honorable Court to grant him a rehearing of said cause.

FRANCIS M. HARTMAN,
EDWIN F. JONES,
Attorneys for Petitioner.

I, Edwin F. Jones, one of the attorneys for petitioner herein, do hereby certify that in my judgment the foregoing petition for a rehearing is well-founded and that the same is not interposed for delay.

Edwin F. Jones